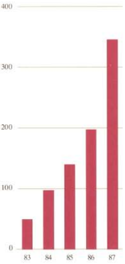
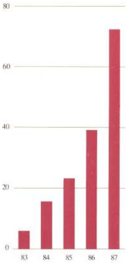
Microsoft

(In thousands, except net income per share)	Year Ended June 30				
	1987	1986	1985	1984	1983
For the year:					
Net revenues	345,890	197,514	140,417	97,479	50,065
Net income	71,878	39,254	24,101	15,880	6,487
Net income per share*	1.30	0.78	0.52	0.35	0.14
Average common and common equivalent shares outstanding*	55,270	50,400	46,520	45,894	45,362
At year-end:					
Working capital	166,358	118,452	41,442	21,458	9,024
Total assets	287,754	170,739	65,064	47,637	24,328
Stockholders' equity	239,105	139,332	54,440	30,712	14,639
Key ratios:					
Current ratio	4.6	5.0	4.9	2.3	1.9
Return on net revenues	20.8%	19.9%	17.2%	16.3%	13.0%

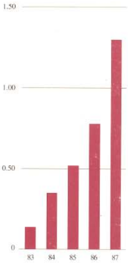
Net Revenues
(In millions)



Net Income
(In millions)



*Net Income Per Share**



**Net income per share and average common and common equivalent shares outstanding have been retroactively restated to reflect the August 1, 1987 two-for-one stock split described in Note 1 of Notes to Consolidated Financial Statements.*

To Our Shareholders

Over the past twelve months, our Company has produced record results.

Revenues equalled $345.9 million, a 75% increase over the $197.5 million recorded in fiscal 1986.

Both net income and net income per share reached all-time highs. Net income grew to $71.9 million, up 83% from last year. Net income per share was $1.30, up 67% from last year. Net income per share reflects an August 1, 1987 two-for-one stock split.

A comprehensive comparison of these figures requires additional discussion. In response to the Tax Reform Act of 1986, the Company initiated two programs related to its incentive stock options, under which employees are paid a bonus for electing to take actions that result in a tax benefit to the Company. The net benefit of these programs through June 30 was $18.2 million, and depending principally on the future market value of the Company's common stock, could equal from $30 million to $60 million through 1992.

Under current accounting rules, the Company reports the gross benefit of the programs as a contribution to capital, and the bonus net of directly related tax benefit as a charge to income, reducing net income. Had these programs not been undertaken, net income would have equaled $78.1 million, up 99% from the $39.3 million of last year. Net income per share would have been $1.40, an increase of 79% from the $0.78 of last year.

Revenues and profits increased across all channels of distribution and in all product groups. Our retail operations were strong throughout the year, even during the industry's traditionally slow season. Additionally, our international operations showed continued strength.

This year marks several milestones that we believe will be essential to the long-term growth of the Company.

Product introductions and announcements.

We benefited this year from having a mix of established, proven products with a high degree of market acceptance and from introducing several new products that kept the Microsoft name at the forefront of our industry.

Probably the year's most significant announcement was the April 2 unveiling of Microsoft® Operating System/2 (Microsoft OS/2), with the Presentation Manager based on Microsoft Windows. At the same time, we announced the Microsoft OS/2 LAN Manager, an advanced local area network operating environment.

These announcements take our leadership in operating systems and networks into the next generation of personal computing by setting a new software standard designed to let customers take full advantage of the latest hardware.

Microsoft OS/2 is scheduled to be available in early 1988. Until then, customers who want to benefit from some of the features of this next generation of software can use a new, more advanced version of MS-DOS® (Version 3.3), along with Version 2.0 of Microsoft Windows.

Independent developers already have shown serious interest in the Microsoft OS/2 environment. Since the introduction, we have offered well-attended seminars about Microsoft OS/2 in Seattle and New York City, and we are planning to hold two more in the fall.

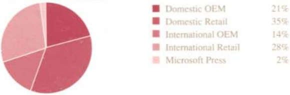
In other systems software activity, we introduced an 80386-based version of XENIX®, Microsoft's implementation of UNIX® System V, the first operating system to fully exploit all the features of the 80386. Microsoft also announced an agreement whereby we will develop for AT&T a new version of UNIX for the 80386 that will combine the best features of XENIX and AT&T® System V technology. This version is expected to be ready in 1988. As part of the agreement,

Jon A. Shirley *William H. Gates*

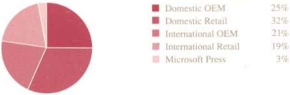
1987 Revenues by Product Group

1986 Revenues by Product Group

1987 Revenues by Channel



1986 Revenues by Channel



AT&T will license its trademark, UNIX, for the first time.

We also provided extensions to the MS-DOS operating system that support the use of high-capacity CD ROM (Compact Disc Read Only Memory) disc drives with personal computers. This latter development provided the backdrop for our first consumer CD ROM product—Microsoft Bookshelf, a library of ten useful reference tools on a single CD ROM disc.

On the applications software front, we reinforced our market leadership in Apple® Macintosh™ systems with our introduction of Microsoft Works, an integrated software product. We also made a significant update to the Microsoft Word word processing program and continued to support and update the top-selling Microsoft Excel spreadsheet.

Among our MS-DOS products, we have seen increasing market acceptance for both our Microsoft Word word processing program and the Microsoft Mouse pointing device. Both were considered visionary when we introduced them just a couple of years ago. Today, they are commonplace in offices around the world. Sales of the Microsoft Mouse, for example, have surpassed a half-million units.

Language products—the foundation upon which our Company was built a decade ago—continue to be important in our product mix. We introduced a variety of new language products, such as the Microsoft QuickC compiler for IBM and compatible personal computers and the Microsoft BASIC compiler for Apple Macintosh systems. We also made major updates to Microsoft C Compiler and Microsoft FORTRAN and Microsoft QuickBASIC compilers.

Strategic relationships.

We have established strategic relationships with a variety of

other companies. These relationships go above and beyond our ongoing activities as a systems developer with most of today's leading hardware manufacturers. For example, we continue to work closely on new technologies with IBM through our joint development agreements.

In January, we announced an alliance with Hewlett-Packard and Aldus Corporation to promote a Microsoft Windows-based solution for the growing desktop publishing market for machines running the MS-DOS operating system. During our second annual international conference on CD ROM in March (attended by more than 1,200 people), we announced a joint venture with two major European companies—Olivetti and SEAT (Societa Elenchi Ufficiali Degli Abbonati al Telefone p.A.)—to form a new company, Eikon Corporation. Eikon will provide a focus for the design, development, production, and marketing of CD ROM products for the European market.

We sponsored a series of seminars with Intel and Businessland to help explain the transition from MS-DOS to Microsoft OS/2. And we have entered into a strategic relationship with 3Com to co-develop and jointly market the Microsoft OS/2 LAN Manager.

With an eye toward future growth, we made two important investments in other companies. In June, we announced a $1 million minority equity investment and product licensing agreement with Natural Language Incorporated (NLI) of Berkeley, California. NLI's first product, the NLI DataTalker™, is an English-language interface that allows novice users to access databases in plain English.

On July 31, 1987, Microsoft acquired Forethought, Inc., an applications software company based in Sunnyvale, California. Under the agreement, Forethought becomes the Microsoft Graphics Business Unit, and its product—PowerPoint™, a desktop presentations program—joins our family of Macintosh applications.

The future.

We look to the future with both enthusiasm and caution. Over the past twelve months, the Company has made a significant investment in research and development. Over the next twelve months, you will see a variety of products that result directly from that investment.

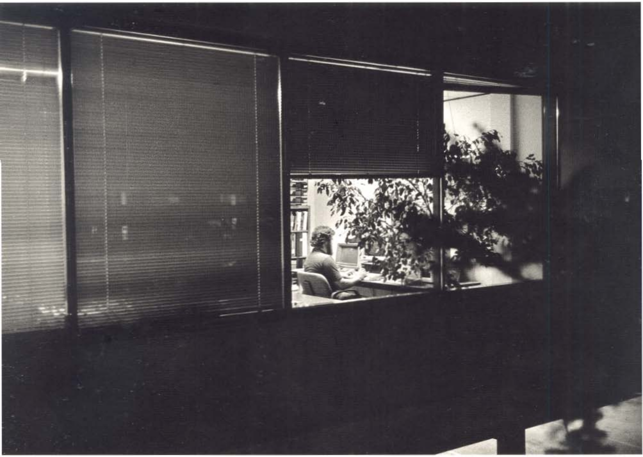
Our next important goal is to build market acceptance for these products, while preparing the market for the advances represented by Microsoft OS/2. This will require an increase in spending for marketing programs.

At the same time, our commitment to R&D will continue. In fact, we expect future R&D expenses to grow at a faster rate than revenues.

We are about to embark upon a new era in software, bringing to the market products that result from our visionary work in the development of graphics user interfaces and networking. We believe our contributions to this new era will keep Microsoft at the forefront of the industry and set the stage for continued growth in years to come.

Jon A. Shirley
President and Chief Operating Officer

William H. Gates
Chairman of the Board and Chief Executive Officer



It takes a lot of late hours—and a companywide commitment—to create the software for the next generation of personal computing. At Microsoft, nearly 600 employees are assigned to our product development groups. Most software is developed in-house, using proprietary tools that allow us to share technology between products.

Microsoft. The Company.

Behind everything we do as a Company lies a single mission, first expressed by our founders in 1975: *to put a computer on every desk and in every home.*

At that time, a lot of people thought computers were nothing more than a novelty. And frankly, it took real vision to look at those early machines, with their makeshift keyboards and TV-type displays, and think "business."

But at Microsoft, we've never allowed our imagination to be stifled by the limits of today's technology. So we looked beyond those first machines and saw a revolution in the making. Because computers had the one capability that no invention before them had ever possessed: They could be reinvented—over and over—with software.

Software is the very soul of the machine. It transforms the hardware from a lifeless piece of technology into a vital tool. By inventing new software for a computer, we virtually reinvent the machine itself. It is transformed into a smart typewriter. An electronic spreadsheet. A project manager. It can take on multiple personalities, becoming a teacher, an artist, a business associate.

Back in 1975, those possibilities weren't apparent to most people. But now, a dozen years later, we have seen how this technology has fundamentally changed how millions of people do business.

By committing our Company to software development, Microsoft positioned itself at the center of that change. We helped shape the computer revolution, first by creating the basic tools—the systems and languages—that brought it to life, and later by carrying our experience and expertise across a full line of application products.

What's more, we have been able to bridge the changing hardware technologies, from the core developments of the Altair and the Apple II of the mid-1970s to the IBM® PC and compatibles of the early 1980s, all the way to the newest graphics-driven machines such as the Macintosh and the IBM Personal System/2™ series.

Microsoft. Our vision.

Why has Microsoft been able to bridge the changing hardware technologies successfully? Simply because we have complemented our mission by committing our Company to an extraordinary idea—that the visions of individual employees should flourish.

In that spirit, we give our people room for innovation. For instance, we encourage our

Microsoft makes news, with this year's most important software announcement: Microsoft Operating System/2 with the Presentation Manager based on Microsoft Windows technology. Selected by IBM as the basis for its future computing standards, Microsoft OS/2 represents the latest step in our four-year-old commitment to the development of a standard graphics user interface.

As software becomes more advanced, the tools for teaching it need to become more sophisticated. Helping customers over their initial hurdles is the main goal of Microsoft's award-winning computer-based training group. These training specialists create computerized tools that take customers step by step through our products, allowing them to learn in a dynamic, hands-on way.

development staff to look beyond the hardware of today to design the software of tomorrow. We look to our sales organization to find new ways of getting products into customer hands by aggressively developing new channels. And we ask our support specialists to provide ever-higher levels of service while they simultaneously support an ever-growing base of customers.

In short, we give our employees the opportunity to do their best work while rewarding them with the chance of a lifetime to make their marks.

It's one of the main reasons why so many important software innovations have come from Microsoft over the past dozen years.

But that's history. Where will this mission and this commitment lead us next?

In the following pages, we describe just a few of the key product areas that we believe are going to make a difference in the not-too-distant future, starting with one of our most important product announcements from last year.

Microsoft OS/2.

In late 1983, our Company declared its commitment to develop a graphics user interface (that is, a series of visual tools that give customers an intuitive way to control their computers).

This was before Macintosh. Before the current crop of machines built around the Intel® 80286 and 80386 microprocessors.

We were out on a limb, and there were plenty of naysayers ready to tell us so. But Microsoft knew that the only way to make our mission a reality was to make software smart about people and the way they work.

So we began developing the Microsoft Windows graphics-based operating environment and introduced it in September, 1985. Since then, we have sold more than a million copies of Windows.

Even more important, the graphics user interface of the Windows Presentation Manager has been incorporated into Microsoft OS/2, the operating system selected by IBM for its new Personal System/2 series. Many other leading hardware manufacturers—including Apricot, COMPAQ, Donatec, ICL, ITT, Leonard, NCR, Nokia, Normerel, Olivetti, RML, Siemens, Tandy, and Wang—have also announced plans to license and support Microsoft OS/2.

What this means is that, eventually, all applications will use the Windows presentation manager as a standard interface, making it possible for users to master new programs faster than ever

One of the top-selling word processing programs, Microsoft Word is available in IBM and Apple Macintosh versions, as well as in several international editions. With its unparalleled collection of advanced features (including the ability to transfer formatted files between IBM and Macintosh systems), Word represents a prime example of our fundamental product philosophy—to bring the benefits of the latest technology to our customers.

Launched in January 1987, Microsoft University is a new business venture that offers technical education for corporate and independent developers. Classes include instruction on how to write programs for Microsoft Windows, Microsoft OS/2, and Microsoft C Compiler. Through this curriculum, we are able to build excitement for our products by providing direct support to the developers who use them.

before. It will allow personal computer users to work with a variety of different systems, because all of them will look and perform the same.

Plus, Windows and Microsoft OS/2 will make it possible to work with multiple applications simultaneously and to integrate graphics and data from different applications more efficiently. This advantage takes us generations beyond the all-in-one approach to software integration of the past, which required the customer to sacrifice functionality for integration.

It's all possible now simply because the hardware—with its higher resolution, faster speed, and improved output—has the capabilities necessary to match our original vision, making the advantages of the Windows interface apparent to a much broader base of customers.

Networking.

"One person, one computer." A simple idea. But an idea so revolutionary that it changed the shape of office computing forever.

Think back to 1975. Most people believed then that the future of office computing would be based upon the idea of a single processor running on a central mainframe computer. Many people, one computer.

But the popularity of personal computers quickly changed the way a lot of companies thought about their computing needs. In the excitement over this new technology, many people lost sight of an important fact—that people working together often need to exchange data and information.

At Microsoft, though, we never lost sight of that reality. We were one of the first companies to design our applications for network use. And within Microsoft, we have installed a campus-wide network as the basis for our own electronic mail system and development activities.

That firsthand experience has helped us refine our vision of how computers can be linked most effectively. For instance, it is now apparent that the personal computer, with its localized processing features, will become the standard workstation in most office automation schemes.

With this in mind, in April we announced the Microsoft OS/2 LAN Manager, which establishes a new standard for making connections between computers running both the MS-DOS and Microsoft OS/2 operating systems. Companies that build networking systems around the LAN Manager will realize a variety of advantages from giving their people the ability to share resources and access centralized information banks.

We have committed ourselves to this broader networking role, knowing that our customers will

Microsoft Press, the book-publishing arm of the Company, introduced 35 new titles in fiscal 1987, nearly equalling the combined output of its first three years. More than 2.5 million copies of Microsoft Press books are in print and 23 titles have made best-seller lists. Press books are now published in 13 languages and sold in 47 countries.

In its first full year as a wholly owned subsidiary, Microsoft KK maintained our established leadership in Japan by strengthening relationships with leading Japanese computer manufacturers, key distributors, and dealers. In June we introduced a new Japanese version of Microsoft Multiplan® through the combined efforts of our Redmond and Tokyo research and development teams.

soon be asking for a clear and simple way to move information quickly and smoothly from system to system.

When that happens, networking won't be just a vision any more. It will be an absolute necessity for doing business.

Business applications.

When we entered the applications business in 1982, the IBM Personal Computer was just coming into prominence, and a lot of corporations were starting to seriously explore whether these new machines could really be the basis for their computing future.

We believed then, as we do now, that the best way to answer the needs of these corporations was to build the benefits of the latest technology into our products. That is why, for example, the Microsoft Word word processing program was among the first to provide support for laser printers—and why that support was included in the program even before those printers became readily available. And it is why Microsoft was the first company to ship applications software for the Macintosh in 1984.

Today Microsoft markets a wide variety of applications products for both the MS-DOS and Macintosh environments, including word processors, spreadsheets, and programs for business graphics, communications, and project management. We are the leader in Macintosh applications, in part because we were among the first to understand how to build advanced applications around the new development platform represented by Macintosh with its graphics user interface.

Similarly, we have made an early, major commitment to develop applications for the new platform represented by Windows and Microsoft OS/2, the foundation of the new generation of software. The first of these products will appear during the next fiscal year.

We have also designed our applications to take maximum advantage of local area networks, which will form the basis for our future office automation solutions.

Getting products to customers.

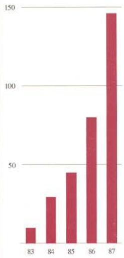
In the same way that we are on the verge of creating many innovative new products, we are beginning to distribute and promote those products in some exciting new ways.

This is why we changed our corporate logo and packaging, moving to a look that more accurately reflects the dynamic way we do business.

It is also why we are committed to broadening our product distribution channels by defining

Five years ago, we had a vision that the international market for personal computing would someday be as important as the domestic one. Today, Microsoft is the undisputed leader in international software, with 42% of total revenues generated outside the United States. Many products have been localized to native languages and conventions.

International Net Revenues
(In millions)



Set on a 53-acre site in Redmond, Washington, the Microsoft corporate campus provides a beautiful working environment for employees while giving the Company ample room for future growth. Here and around the world, more than 1,800 Microsoft employees work to realize our Company's collective vision of putting a computer on every desk and in every home.

our marketing programs to reach more targeted market segments.

To make this possible, we created a new U.S. Sales and Marketing Division and appointed Scott Oki as senior vice president in charge of it. During the year, we made major changes in our field organization, doubling the number of people in the field and tripling the number of sales people assigned to work with large national accounts. In the process, we made a major recommitment to our established distributor and dealer base, recognizing that, collectively, they have the broad geographic coverage that is necessary to reach our wide range of customers, as well as the ability to work closely with them to serve their individual needs.

Internationally, we opened an office in Mexico, adding it to our existing subsidiaries in Australia, Canada, England, France, West Germany, Ireland, Italy, Japan, the Netherlands, and Sweden. We have localized our products for a variety of languages and conventions, including versions in Arabic, Danish, Dutch, international English, Finnish, French, French Canadian, German, Greek, Hebrew, Hungarian, Italian, Japanese, Korean, Norwegian, Portuguese, Spanish, Swedish, and Turkish. The result? International revenues continue to be strong, growing by 83% this year.

Where do we go from here?

It isn't enough for the Company to possess a vision. We must also understand how to put that vision into action. We believe there are just a few concepts essential to making these goals a reality:

We must listen carefully to what our customers tell us, and be prepared to fine-tune our concepts, adjusting the details according to what those customers need.

We must execute our strategic plans in a timely fashion, and successfully bring our products to market.

We must continue to encourage our employees to create their own visions, and to act upon those ideas for the good of the Company.

At Microsoft, we have many products designed to serve many different markets. But it is our vision as a Company that is the most important.

That vision defines who we are. That vision shapes what we will become.

Our first consumer product to take advantage of CD ROM (Compact Disc Read Only Memory) technology, Microsoft Bookshelf collects ten respected reference sources on a single disc, giving customers instant access to an "electronic bookshelf" of information. CD ROM discs can contain up to a thousand times more information than a standard floppy disk and can combine text, video, and audio into multimedia presentations.

Microsoft markets a complete line of business applications and language products, available from dealers worldwide. These products include:

	Operating System		
	MS-DOS	XENIX	Apple Macintosh
Application software			
Microsoft Access	■		
Microsoft Chart	■		■
Microsoft Excel			■
Microsoft File			■
Microsoft Flight Simulator	■		■
Microsoft Learning DOS	■		
Microsoft Multiplan	■		■
Microsoft Project	■		
Microsoft Word	■		■
Microsoft Works			■
Microsoft PowerPoint™			■
System/Language software			
Microsoft BASIC	■		■
Microsoft BASIC Compiler	■		■
Microsoft Business BASIC Compiler	■		
Microsoft C Compiler	■		
Microsoft COBOL	■		
Microsoft FORTRAN	■		■
Microsoft LISP	■		
Microsoft Macro Assembler	■		
Microsoft muMATH™	■		
Microsoft Pascal	■		
Microsoft QuickBASIC	■		
Microsoft Sort	■		
Microsoft Windows	■		
XENIX System V/286		■	
XENIX System V/386		■	
Hardware			
Microsoft MACH 20	■		
Microsoft Mouse	■		

Microsoft Corporation 1987 Financial Results

(In millions)

Net Revenues

	1987	% Change	1986	% Change	1985
Net revenues	$345.9	75	$197.5	41	$140.4

The annual increases in the Company's net revenues have resulted from several factors, including the introduction of new products and enhancements to existing products, the expansion of the Company's export sales and foreign operations, and the general expansion of the market for microcomputer software. Two main factors contributed to the Company's net revenue growth in 1987. First, the strength of its retail operations enabled the Company to take advantage of strong computer shipments worldwide. Second, the Company was able to continue its pattern of steady revenue growth in all product groups and across all channels of distribution, both domestically and internationally. Significant product introductions in 1987 included Microsoft Learning DOS, Microsoft Multiplan 3.0, Microsoft FORTRAN 4.0 and Microsoft QuickBASIC 3.0 for IBM Personal computers and compatibles; Microsoft Works and Microsoft Word 3.0 for the Apple Macintosh; and Microsoft Mouse 6.0. Significant product introductions in 1986 included Microsoft Multiplan 2.0, Microsoft Chart 2.0 and Microsoft Word 3.0 for IBM Personal Computers and compatibles; Microsoft Excel and Microsoft Flight Simulator for the Apple Macintosh; Microsoft Windows operating environment; and Microsoft Mouse 5.0.

International net revenues for fiscal years 1987, 1986, and 1985 were $146.2 million, $80.0 million, and $44.6 million. The amounts represented 42.3%, 40.5% and 31.8% of total net revenues for the respective years. This growth resulted from several factors, including successful product localization, expansion to additional foreign markets, and favorable foreign currency exchange rates. For additional information concerning foreign operations and export sales, see page 30.

Cost of Revenues

	1987	% Change	1986	% Change	1985
Cost of revenues	$73.9	81	$40.9	34	$30.4
Percentage of net revenues	21.4%		20.7%		21.7%

Cost of revenues as a percentage of net revenues has remained fairly stable during the three years presented. Although the change from 1986 (20.7%) to 1987 (21.4%) is minimal, it is the net result of two offsetting situations. The Company experienced a shift in revenue mix to a greater contribution from worldwide retail and hardware products, which increased cost of revenues as a percentage of net revenues. An offsetting decrease resulted from the termination of an agency agreement with a Japanese company and the formation of a wholly owned subsidiary in Japan in February 1986. Cost of revenues for 1986 and 1985 included $5.1 million (2.6% of net revenues) and $5.2 million (3.7% of net revenues) paid under this agency agreement.

Operating Expenses

	1987	% Change	1986	% Change	1985
Research and development	$38.1	86	$20.5	20	$17.1
Percentage of net revenues	11.0%		10.4%		12.2%
Sales and marketing	$85.1	48	$57.7	36	$42.5
Percentage of net revenues	24.6%		29.2%		30.3%
General and administrative	$22.0	25	$17.6	86	$ 9.4
Percentage of net revenues	6.4%		8.9%		6.7%

Research and development expenses encompass primarily compensation and facility costs for internal development, cost of freelance developers, and acquired technology. Research and development expenses have increased as a result of (1) planned additions in the Company's software development staff, (2) expenses related to product localization, (3) expenses related to exploration of CD ROM technology, and (4) amortization of the cost of acquired technology. Management presently anticipates that research and development expenses will grow at a faster rate than net revenues.

Sales and marketing expenses include compensation, travel, and facility costs for the Company's sales and product support personnel, along with marketing and advertising. The growth in these expenses, although not in proportion with net revenues, reflects the continuing expansion of the Company's domestic and international sales and marketing staff, as well as increased marketing and advertising.

The increase in general and administrative expenses is primarily attributable to the growth in administrative staff necessary to support the Company's increased revenue volume. The 1986 expenses reflect the Company's move to new corporate facilities in March 1986.

Non-operating Income

	1987	% Change	1986	% Change	1985
Non-operating income	$8.6	69	$5.1	168	$1.9
Percentage of net revenues	2.5%		2.6%		1.4%

Non-operating income includes investment income of $7.3 million, $3.2 million, and $900,000 for fiscal years 1987, 1986 and 1985. The growth in investment income is attributable to a larger investment portfolio resulting from funds generated from operations and proceeds of $44.8 million from the Company's initial public offering in March 1986. Results also include foreign currency transaction gains of $1.7 million and $2.0 million in 1987 and 1986. The 1985 results include a short-term capital gain of $1.0 million on the sale of marketable equity securities.

Stock Option Bonus

Stock option bonus expense is the result of stock option bonus programs adopted by the Company during fiscal 1987 in response to the Tax Reform Act of 1986. As discussed in Note 7 of Notes to Consolidated Financial Statements, under these programs employees are paid a cash bonus based on tax benefits the Company receives when employees sell certain option stock or exercise certain options after having agreed to changes in the options' tax attributes. As required by generally accepted accounting principles, the Company reported a $24.4 million tax benefit realized from these programs through June 30, 1987 as a capital contribution, but charged the related $14.2 million bonus to operations and reduced the provision for income tax by an $8.0 million tax benefit based only on the bonus, reducing 1987 net income by $6.2 million, or $0.10 per share.* The total net benefit from these programs was $18.2 million, or $0.32 per share, through June 30, 1987.* The total net benefit to be received from these programs depends upon the market value of the company's stock and other factors and could be from $30 to $60 million through 1992.

Provision for Income Taxes

	1987	% Change	1986	% Change	1985
Provision for income taxes	$49.5	85	$26.7	43	$18.7
Percentage of net revenues	14.3%		13.5%		13.3%
Effective tax rate	40.8%		40.5%		43.7%

For an analysis of the differences between the statutory and the effective income tax rates, see Note 6 of Notes to Consolidated Financial Statements.

The Tax Reform Act of 1986 (TRA) significantly changes the federal income taxation of corporations. Its provisions include an overall reduction in corporate income tax rates, elimination of the investment tax credit, reduction in the availability of foreign tax credits, changes in depreciation rates and lives, and various provisions which affect specific industries. Certain provisions may have a material effect on the results of operations and the financial condition of future periods. Most notably, effective July 1, 1987, the TRA lowers the top corporate tax rate from 46% to 34%. Elimination of investment tax credits, changes in the depreciation rates and lives, and reduction in the availability of foreign tax credits will not affect the Company's facility expansion plans or foreign operations.

The Financial Accounting Standards Board has proposed new income tax accounting rules which, if adopted in their present form, will not have a significant impact on the Company.

Net Income and Net Income Per Share

	1987	% Change	1986	% Change	1985
Net income	$71.9	83	$39.3	63	$24.1
Percentage of net revenues	20.8%		19.9%		17.2%
Net income per share*	$ 1.30	67	$ 0.78	50	$ 0.52

The increases in net income as a percentage of net revenues result primarily from net revenue growth without proportional increases in operating expenses.

Had the one-time stock option bonus programs previously discussed not been adopted, net income and net income per share would have been as follows:

Pro forma Information
(Bonus programs not adopted)

	1987	% Change	1986	% Change	1985
Pro forma net income	$78.1	99	$39.3	63	$24.1
Percentage of net revenues	22.6%		19.9%		17.2%
Pro forma net income per share*	$ 1.40	79	$ 0.78	50	$ 0.52

The Company believes that the gross tax benefit under the stock option bonus programs ($24.4 million) should increase net income and not be treated as a capital contribution. Until recently, new income tax accounting rules proposed by the Financial Accounting Standards Board contained a provision for this benefit to increase net income. However, the Board has also been reconsidering accounting for stock issued to employees and in May 1987 decided accounting for stock-related tax benefits should be considered along with other stock matters, rather than with the proposed new general tax rules. New rules in the stock area have not yet been formally proposed. The following supplemental pro forma information shows the effect of recording the tax benefit as an increase in net income as opposed to a capital contribution.

Pro forma Information
(Tax benefit increases net income)

	1987	% Change	1986	% Change	1985
Pro forma net income	$96.3	145	$39.3	63	$24.1
Percentage of net revenues	27.8%		19.9%		17.2%
Pro forma net income per share*	$ 1.72	121	$ 0.78	50	$ 0.52

** Net income per share and pro forma net income per share have been retroactively restated to reflect the August 1, 1987 two-for-one stock split described in Note 1 of Notes to Consolidated Financial Statements.*

Microsoft Corporation Consolidated Statements of Income

(In thousands, except net income per share)

	Year Ended June 30		
	1987	1986	1985
Net revenues	$345,890	$197,514	$140,417
Costs and expenses:			
Cost of revenues	73,854	40,862	30,447
Research and development	38,076	20,523	17,108
Sales and marketing	85,070	57,668	42,512
General and administrative	22,003	17,555	9,443
Total cost and expenses	219,003	136,608	99,510
Income from operations	126,887	60,906	40,907
Non-operating income (Note 1)	8,638	5,078	1,936
Stock option bonus (Note 7)	(14,187)	—	—
Income before income taxes	121,338	65,984	42,843
Provision for income taxes (Note 6)	49,460	26,730	18,742
Net income	$ 71,878	$ 39,254	$ 24,101
Net income per share*	$ 1.30	$ 0.78	$ 0.52
Average common and common equivalent shares outstanding*	55,270	50,400	46,520

** Net income per share and average common and common equivalent shares outstanding have been retroactively restated to reflect the August 1, 1987 two-for-one stock split described in Note 1 of Notes to Consolidated Financial Statements.*

See accompanying notes.

Total assets at June 30, 1987 were $287.8 million, compared to $170.7 million at June 30, 1986 and $65.1 million at June 30, 1985. Over the last five years, total assets have grown at an annual rate of 81%.

Working capital at June 30, 1987 was $166.4 million, compared to $118.5 million at June 30, 1986 and $41.4 million at June 30, 1985. The current ratios, the relationship of current assets to current liabilities, stood at 4.6 to 1, 5.0 to 1, and 4.9 to 1 at the respective balance sheet dates.

Working capital provided during fiscal 1987 totaled $105.0 million, of which $79.4 million was provided from operations. Another significant source of working capital was the $24.4 million tax benefit obtained by the Company as a result of the stock option bonus programs discussed in Note 7 of Notes to Consolidated Financial Statements.

Working capital used during fiscal 1987 totaled $57.1 million and was used almost entirely for additions to property, plant, and equipment. In August 1986, the Company purchased approximately 20 acres of undeveloped land adjacent to its corporate campus in Redmond, Washington for $5.3 million. In June 1987, the Company purchased an additional 56 acres adjacent to its corporate campus for $21.8 million and approximately 23 acres for a new manufacturing and distribution facility in Snohomish County, Washington for $4.3 million. Construction has begun on this 260,000-square-foot manufacturing and distribution facility, anticipated to be completed in the third quarter of fiscal 1988. Also, during the fourth quarter of fiscal 1987, the Company completed construction of two corporate campus buildings at a total cost of approximately $10.4 million.

Cash and short-term investments grew $29.8 million during fiscal 1987 to $132.5 million and comprised 62% of current assets and 46% of total assets at June 30, 1987.

Working capital provided during fiscal 1986 totaled $93.2 million, of which $45.0 million was provided from operations and $44.8 million was provided from the Company's initial public offering in March 1986. Working capital used during fiscal 1986 totaled $16.2 million and included $14.1 million invested in property, plant, and equipment.

Resolution of Contingencies. During fiscal 1987 the Company resolved two contingencies. First, as discussed in Note 6 of Notes to Consolidated Financial Statements, passage of the Tax Reform Act of 1986 removed the Company from possible personal holding company status. Second, as discussed in Note 9 of Notes to Consoldated Financial Statements, the Company settled a lawsuit.

Subsequent Event. On July 31, 1987, the Company aquired principally intellectual property rights in the desktop presentations category by acquiring 100% of the outstanding capital stock of Forethought, Inc. The purchase of these assets will be recorded in the financial statements at their net cost, approximately $12 million, and amortized over a three-year period. Forethought, Inc.'s results of operations are not presently material in relation to those of the Company.

(In thousands, except share data)

	June 30	
	1987	1986
Assets		
Current assets:		
Cash and short-term investments	$132,484	$102,676
Accounts receivable—net of allowance of $6,954 and $4,060	55,131	34,499
Inventories (Note 2)	16,555	8,008
Other	8,832	2,797
Total current assets	213,002	147,980
Property, plant, and equipment—net (Notes 3 and 4)	70,010	19,544
Other assets	4,742	3,215
	$287,754	$170,739
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 16,513	$ 6,842
Customer deposits and deferred revenue	6,289	6,951
Royalties and commissions payable	4,013	2,929
Accrued compensation and employee benefits	5,127	1,319
Notes payable (Note 5)	5,172	—
Income taxes payable (Note 6)	2,217	7,472
Other	7,313	4,015
Total current liabilities	46,644	29,528
Capital lease obligations (Note 4)	2,005	1,879
Commitments and contingencies (Notes 3, 4, and 7)	—	—
Total liabilities	48,649	31,407
Stockholders' equity (Note 8):		
Common stock—$.001 par value; shares authorized 60,000,000; issued and outstanding 52,713,056* and 51,039,962*	53	51
Paid-in capital	76,811	50,767
Retained earnings	161,106	89,228
Translation adjustment	1,135	(714)
Total stockholders' equity	239,105	139,332
	$287,754	$170,739

Shares issued and outstanding have been retroactively restated to reflect the August 1, 1987 two-for-one stock split described in Note 1 of Notes to Consolidated Financial Statements.

See accompanying notes.

(In thousands, except share data)

	Preferred Stock		Common Stock		Paid-In Capital	Retained Earnings	Translation Adjustment	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balance, June 30, 1984	500,000	$ 5	42,520,454	$43	$ 4,851	$ 25,873	$ (60)	$ 30,712
Sale of stock, principally to employees	—	—	546,252	—	146	—	—	146
Amortization of deferred compensation	—	—	—	—	83	—	—	83
Net income	—	—	—	—	—	24,101	—	24,101
Translation adustment	—	—	—	—	—	—	(602)	(602)
Balance, June 30, 1985	500,000	5	43,066,706	43	5,080	49,974	(662)	54,440
Sale of stock in initial public offering	—	—	4,600,000	5	44,834	—	—	44,839
Conversion of preferred stock	(500,000)	(5)	2,000,000	2	3	—	—	—
Sale of stock, principally to employees	—	—	1,373,256	1	850	—	—	851
Net income	—	—	—	—	—	39,254	—	39,254
Translation adjustment	—	—	—	—	—	—	(52)	(52)
Balance, June 30, 1986	—	—	51,039,962	51	50,767	89,228	(714)	139,332
Sale of stock, principally to employees	—	—	1,673,094	2	1,696	—	—	1,698
Income tax benefit related to stock options (Note 7)	—	—	—	—	24,348	—	—	24,348
Net income	—	—	—	—	—	71,878	—	71,878
Translation adjustment	—	—	—	—	—	—	1,849	1,849
Balance, June 30, 1987	—	—	52,713,056	$53	$76,811	$161,106	$1,135	$239,105

Consolidated Statements of Stockholders' Equity have been retroactively restated to reflect the August 1, 1987 two-for-one stock split described in Note 1 of Notes to Consolidated Financial Statements.

See accompanying notes.

(In thousands)

	Year Ended June 30		
	1987	1986	1985
Working capital provided:			
Operations:			
Net income	$ 71,878	$39,254	$24,101
Depreciation	7,551	5,754	3,462
Total from operations	79,429	45,008	27,563
Common stock issued	1,066	46,279	368
Income tax benefit related to stock options (Note 7)	24,348	—	—
Long-term obligations	126	1,879	—
Total working capital provided	104,969	93,166	27,931
Working capital used:			
Additions to property, plant, and equipment (Note 3)	58,017	14,108	6,576
Loans to stockholders – net	(632)	589	213
Translation adjustment	(1,849)	52	602
Other	1,527	1,407	556
Total working capital used	57,063	16,156	7,947
Increase in working capital	$ 47,906	$77,010	$19,984
Changes in elements of working capital:			
Current assets – increase (decrease):			
Cash and short-term investments	$ 29,808	$83,728	$15,666
Accounts receivable	20,632	9,226	1,707
Inventories	8,547	2,089	(3,851)
Other	6,035	871	597
Current liabilities – (increase) decrease	(17,116)	(18,904)	5,865
Increase in working capital	$ 47,906	$77,010	$19,984

See accompanying notes.

Presentation of Financial Information

Management's explanation and interpretation of the Company's overall results of operations and financial position, together with the basic financial statements, as presented in the preceding section, should be read in conjunction with the entire report. The notes to consolidated financial statements, an integral part of the basic financial statements, provide additional detailed financial information.

Management is responsible for the preparation of the Company's consolidated financial statements and related information appearing in this annual report. Management believes that the consolidated financial statements fairly reflect the form and substance of transactions and that the financial statements reasonably present the Company's financial position and results of operations in conformity with generally accepted accounting principles. Management has also included in the Company's financial statements amounts that are based on estimates and judgments which it believes are reasonable under the circumstances.

The independent accountants examine the Company's consolidated financial statements in accordance with generally accepted auditing standards and provide an objective, independent review of the fairness of reported results of operations and financial position.

The Board of Directors of the Company now has an Audit Committee composed of non-management Directors. The Committee will meet periodically with financial management and the independent accountants to review accounting control, auditing, and financial reporting matters.

Francis J. Gaudette

Francis J. Gaudette
Vice President, Finance and Administration; Treasurer; Chief Financial Officer

Opinion of Independent Public Accountants

To the Board of Directors and Stockholders of Microsoft Corporation:

We have examined the consolidated balance sheets (page 23) of Microsoft Corporation and subsidiaries as of June 30, 1987 and 1986, and the related consolidated statements of income (page 21), stockholders' equity (page 24), and changes in financial position (page 25) for each of the three years in the period ended June 30, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such consolidated financial statements present fairly the financial position of Microsoft Corporation and subsidiaries at June 30, 1987 and 1986 and the results of their operations and the changes in their financial position for each of the three years in the period ended June 30, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Deloitte Haskins + Sells

Bellevue, Washington
July 23, 1987 (August 1, 1987 as to Notes 1 and 3)

Note 1. Significant Accounting Policies

Business. The Company's principal business activities are the development, production, marketing, and support of a wide range of software for business and professional use, including operating systems, languages, and application programs, as well as books and hardware for the microcomputer marketplace.

Principles of Consolidation. The consolidated financial statements include the accounts of Microsoft and its wholly owned subsidiaries. Significant intercompany transactions and balances have been eliminated.

Revenue Recognition. Revenue from sales of software and hardware consumer products to distributors or dealers is recognized when the products are shipped. Software products sold to original equipment manufacturers under license agreements generally provide for a commitment fee payable over a minimum commitment period of one to three years. When the product is accepted, the commitment fee is recognized as revenue ratably over the minimum commitment period or on a per unit basis if sales exceed the commitment fee level. Subsequent to the minimum commitment period, revenue based upon the number of systems shipped or copies sold is recognized as earned. Commitment fees received prior to product acceptance are recorded as customer deposits.

Short-term Investments. Short-term investments are carried at cost, which approximates market. Short-term investments at June 30, 1987 consisted principally of municipal bonds, money market preferreds, and increasing rate notes.

Inventories. Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Property, Plant, and Equipment. Property, plant, and equipment is stated at cost and depreciated using straight-line and declining-balance methods over estimated useful lives. Such lives are:

Buildings	30 – 35 years
Leasehold improvements	Lease term
Office furniture and equipment	5 years
Computer equipment	5 years

Warranties and Exchanges. The Company warrants products against defects and has policies permitting distributors and dealers to exchange products under certain circumstances. The Company's policies do not permit return of products for credit or refund. The Company's reserve for warranties and exchanges was $2.0 million and $1.0 million at June 30, 1987 and 1986.

Research and Development and Royalty Costs. A Financial Accounting Standards Board statement requires the capitalization of certain costs of producing software. These costs were immaterial and have been charged to operations. Other research and development costs are expensed as incurred.

Cost of revenues includes royalties paid to authors of certain software products and publications under license agreements. Such royalties, which are based on net revenues, were $9.8 million, $6.1 million, and $4.2 million for the years ended June 30, 1987, 1986, and 1985.

Non-operating Income. Non-operating income includes investment income of $7.3 million, $3.2 million, and $900,000 for the years ended June 30, 1987, 1986, and 1985. Results also include foreign currency transaction gains of $1.7 million and $2.0 million in 1987 and 1986. The 1985 results include a short-term capital gain of $1.0 million on the sale of marketable equity securities.

Income Taxes. Income tax expense includes United States and foreign income taxes, including United States taxes on undistributed earnings of foreign subsidiaries. Certain items of income and expense included in the consolidated financial statements are reported in different years in the tax returns in accordance with applicable income tax laws. The resulting difference between the consolidated financial statement income tax provision and income taxes currently payable is reported in the consolidated financial statements as deferred income taxes. Investment and other tax credits are accounted for as a reduction of tax expense in the year in which the credits reduce taxes payable (flow-through method). The Tax Reform Act of 1986 repealed the investment tax credit as of January 1, 1986.

Foreign Currency Translation. Assets and liabilities denominated in foreign currencies are translated at the exchange rate on the balance sheet date. Revenues, costs, and expenses are translated using an average rate. Translation adjustment resulting from this process is shown separately in stockholders' equity.

Net Income Per Share. Net income per share is computed on the basis of the weighted average number of common and common equivalent shares outstanding and is adjusted for the assumed conversion of preferred shares and shares issuable upon exercise of stock options. The computation assumes the proceeds from the exercise of stock options were used to repurchase common shares at the average market price of the Company's common stock during each period. Prior to the Company's initial public offering of its common stock in March 1986, the average market price of the common stock was determined by independent appraisal.

Stock Split. On August 1, 1987 the Board of Directors declared a two-for-one split of the Company's common stock, effected in the form of a 100% stock dividend payable on September 18, 1987 to shareholders of record on August 21, 1987. All share and per share amounts have been restated to retroactively reflect the stock split.

Note 2. Inventories

Inventories at June 30, 1987 and 1986 were as follows:

(In thousands)	June 30 1987	1986
Raw materials	$ 8,465	$3,626
Work in process	794	444
Finished goods	7,296	3,938
	$16,555	$8,008

Note 3. Non-current Assets

Property. Property, plant, and equipment at June 30, 1987 and 1986 was as follows:

(In thousands)	June 30 1987	1986
Land	$31,437	$ —
Buildings	12,262	1,879
Leasehold improvements	3,909	2,944
Office furniture and equipment	10,465	7,164
Computer equipment	30,524	18,593
	88,597	30,580
Accumulated depreciation	(18,587)	(11,036)
Property, plant, and equipment - net	$70,010	$19,544

In June 1987, the Company purchased approximately 23 acres for a new manufacturing and distribution facility in Snohomish County, Washington. Construction has begun on this 260,000-square-foot facility, anticipated to be completed in the third quarter of fiscal 1988 at a cost of approximately $15 million.

Other. On July 31, 1987, the Company acquired principally intellectual property rights in the desktop presentations category by acquiring 100% of the outstanding capital stock of Forethought, Inc. The purchase of these assets will be recorded in the financial statements at their net cost, approximately $12 million, and amortized over a three-year period. Forethought, Inc.'s results of operations are not presently material in relation to those of the Company.

Note 4. Leases

The Company has operating leases for corporate campus facilities, domestic manufacturing and distribution warehouses, field sales offices, and data processing and other equipment. The noncancelable corporate campus lease expires in 2001 with renewal options through 2011. Rental expense for these operating leases was $5.4 million, $4.5 million, and $3.0 million during the years ended June 30, 1987, 1986, and 1985. In addition, the Company has a capital lease for a foreign manufacturing facility. The facility is included in net property, plant, and equipment at $1.9 million and $1.8 million at June 30, 1987 and 1986. Accumulated amortization is not material. The related obligation is based on future minimum lease payments shown in the following table, less amounts representing interest of $3.9 million at June 30, 1987.

At June 30, 1987, future minimum lease payments for a capital lease and future minimum rental payments under noncancelable operating leases were:

(Dollars in thousands)	Capital Lease	Operating Leases
1988	$ 61	$ 5,593
1989	129	4,734
1990	133	4,318
1991	250	3,555
1992	381	3,382
1993 and thereafter	4,912	22,840
Total minimum payments	$5,866	$44,422

Note 5. Notes Payable

Notes payable are borrowings under a $15 million multicurrency revolving loan agreement used primarily to minimize the Company's exposure to foreign currency fluctuations. The agreement provides for interest at three-eighths of one percent above the London Interbank offered rate and requires no compensating balances or commitment fees.

Note 6. Income Taxes

The income tax provision (benefit) is composed of:

(In thousands)	1987	1986	1985
Current	$48,402	$30,949	$17,363
Deferred	1,058	(4,219)	1,379
	$49,460	$26,730	$18,742

The deferred income tax provision (benefit) is composed of:

(In thousands)	1987	1986	1985
Cash basis tax accounting	$ (459)	$ (2,659)	$2,309
Reserves and expenses not currently deductible–net	(3,688)	(855)	66
Inventory adjustment	(1,127)	(705)	(714)
DISC benefit	—	—	(282)
Undistributed foreign earnings	6,332	—	—
	$1,058	$ (4,219)	$1,379

The Company's effective tax rate differs from the federal rate as follows:

	1987	1986	1985
Federal income taxes at statutory rate	46.0%	46.0%	46.0%
State income taxes, net of federal tax benefit	0.8	1.0	2.8
Tax exempt non-operating income	(1.8)	(1.4)	—
FSC/DISC benefit	(1.1)	(2.0)	(2.9)
Tax credits	(2.8)	(1.4)	(4.7)
Other – net	(0.3)	(1.7)	2.5
	40.8%	40.5%	43.7%

In an Internal Revenue Service examination during fiscal 1986, a field agent proposed that the Company was subject to personal holding company tax. This matter was subsequently resolved by the Tax Reform Act of 1986, which removed the Company from possible personal holding company status.

Note 7. Stock Option Bonus Programs

The Tax Reform Act of 1986 diminished the cost-effectiveness of incentive stock options (ISOs) as an incentive compensation device. During the year ended June 30, 1987, the Company responded with two programs regarding its ISOs. One, available to employees who had exercised certain options, provides a cash bonus for their undertaking a "disqualifying disposition" of stock received upon exercise of the option. A second program, available to employees who held unexercised ISOs, provided them the opportunity to convert ISOs to nonqualified stock options (NSOs), with a cash bonus paid upon exercise of the converted options. The Company receives a tax benefit upon the disqualifying disposition or exercise and the cash bonus is 50% of the Company's benefit.

As required by generally accepted accounting principles, the $24.4 million tax benefit realized from these programs through June 30, 1987 is reported as a capital contribution. The cash bonus from these programs is allocated to compensation expense over the vesting period of the related options resulting, for the year ended June 30, 1987, in stock bonus compensation expense of $14.2 million and a reduction of the provision for income taxes of $8.0 million related directly to the amount of cash bonus expense recognized. The total net benefit from these programs was $18.2 million through June 30, 1987.

Note 8. Stockholders' Equity

Preferred Stock. Preferred stock converted into 2,000,000 shares of common stock automatically upon sale of the Company's common stock in its public offering in March 1986.

Employee Stock Purchase Plan. The Company has an employee stock purchase plan for all employees. Under the plan, shares of the Company's common stock may be purchased at six-month intervals at 85% of the lower of the fair market value on the first or the last day of each six-month period. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period. At June 30, 1987, 68,888 shares of common stock had been purchased under the plan and 531,112 shares were reserved for future issue.

Stock Option Plan. The Company has a stock option plan for officers and key employees which provides for nonqualified and incentive options. The Board of Directors determines the option price (not to be less than fair market value for incentive options) at the date of grant. The options generally expire five years from the date of grant and are exercisable over the period stated in each option.

	Outstanding Options	
(In thousands)	Number	Price per Share
Balance, June 30, 1984	3,857,430	$ 0.24 – $ 1.50
Granted	1,305,430	1.50
Exercised	(428,306)	0.24 – 1.50
Expired	(439,452)	0.24 – 1.50
Balance, June 30, 1985	4,295,102	0.24 – 1.50
Granted	2,465,530	1.50 – 17.00
Exercised	(1,209,532)	0.24 – 2.75
Expired	(532,012)	0.24 – 1.50
Balance, June 30, 1986	5,019,088	0.24 – 17.00
Granted	2,114,000	13.50 – 52.50
Exercised	(1,681,582)	0.24 – 2.75
Expired	(180,104)	0.24 – 52.50
Balance, June 30, 1987	5,271,402	$ 0.24 –$52.50

At June 30, 1987, options for 465,200 shares were exercisable and 101,794 shares were available for future grants under the plan. The reservation of an additional four million shares has been approved by the Board of Directors and will be presented to a vote of stockholders on October 30, 1987.

Note 9. Litigation

On December 15, 1986, the Company agreed to pay $925,000 to Seattle Computer Products, Inc. (SCP) to settle a lawsuit by SCP against the Company in the Superior Court for King County, Washington. The lawsuit, in which SCP originally claimed damages of $60 million, involved a claim by SCP that it had an assignable, perpetual, royalty-free worldwide license for MS-DOS in its current and future versions as a result of a 1981 agreement between the parties pursuant to which the Company purchased from SCP its rights to a disk operating system, which the Company developed into MS-DOS. In consideration of the Company's settlement payment, SCP is assigning back to the Company any and all contracts, agreements, or licenses between the Company and SCP, including any license for the Company's operating system products and high-level languages.

(In thousands)

	Domestic Operations	European Operations	Other Foreign Operations	Eliminations	Consolidated
			Information by Geographic Area		
1987					
Net revenues:					
Unaffiliated customers	$252,623	$ 68,307	$ 24,960	—	$345,890
Affiliates	26,496	46,548	3,237	$ (76,281)	—
Total	$279,119	$114,855	$ 28,197	$ (76,281)	$345,890
Income from operations	$101,485	$ 24,994	$ 3,269	$ (2,861)	$126,887
Identifiable assets	$256,284	$ 64,726	$ 12,250	$ (45,506)	$287,754
1986					
Net revenues:					
Unaffiliated customers	$161,287	$ 28,087	$ 8,140	—	$197,514
Affiliates	19,152	9,979	1,248	$ (30,379)	—
Total	$180,439	$ 38,066	$ 9,388	$ (30,379)	$197,514
Income from operations	$ 55,353	$ 6,151	$ 1,015	$ (1,613)	$ 60,906
Identifiable assets	$169,230	$ 27,830	$ 12,837	$ (39,158)	$170,739
1985					
Net revenues:					
Unaffiliated customers	$123,777	$ 14,066	$ 2,574	—	$140,417
Affiliates	13,807	3,081	24	$ (16,912)	—
Total	$137,584	$ 17,147	$ 2,598	$ (16,912)	$140,417
Income (loss) from operations	$ 42,937	$ 125	$ (503)	$ (1,652)	$ 40,907
Identifiable assets	$ 71,163	$ 9,294	$ 2,825	$ (18,218)	$ 65,064

The Company operates in one business segment — the development, production, marketing, and support of microcomputer software and related books and hardware peripheral devices.

Domestic operations — net revenues from unaffiliated customers include export sales of $53.0 million, $43.8 million, and $28.0 million during the years ended June 30, 1987, 1986, and 1985. These export sales were made primarily to Europe and the Far East. Other foreign operations include subsidiaries in Australia, Canada, and Japan.

Transfers to affiliates are made at market prices, less an allowance for marketing and advertising expenditures.

Cost of revenues during the years ended June 30, 1986 and 1985 includes $5.1 million and $5.2 million paid to a foreign company whose major stockholder is a former director of the Company. The Company terminated its relationship with this foreign company in late fiscal 1986.

(In thousands, except per share data)

	Quarter Ended				
	Sept. 30	Dec. 31	Mar. 31	June 30	Year
1987					
Net revenues	$66,780	$80,985	$98,363	$99,762	$345,890
Income from operations	25,605	30,910	37,914	32,458	126,887
Net income	15,824	19,697	19,100	17,257	71,878
Net income per share*	0.29	0.35	0.35	0.31	1.30
Common stock price per share:*					
High	15-3/4	25-5/8	49-1/2	64-1/8	64-1/8
Low	13	13-3/4	23-3/4	45-1/4	13
1986					
Net revenues	$35,153	$49,897	$50,505	$61,959	$197,514
Income from operations	9,964	16,688	15,394	18,860	60,906
Net income	6,170	10,948	10,629	11,507	39,254
Net income per share*	0.13	0.23	0.21	0.21	0.78
Common stock price per share:*					
High	—	—	14-7/8	17-3/4	17-3/4
Low	—	—	12-3/4	13-3/8	12-3/4

The Company has never paid cash dividends on its common stock. The Company's common stock has been traded on the NASDAQ National Market System since the Company's initial public offering in March 1986. On July 31, 1987, there were 4,127 holders of record of the Company's common stock.

**Net income per share and common stock price per share have been retroactively restated to reflected the August 1, 1987 two-for-one stock split described in Note 1 of Notes to Consolidated Financial Statements.*

Microsoft Corporation Selected Five-Year Financial Data

(In thousands, except employee and per share data)

	Year Ended June 30				
	1987	1986	1985	1984	1983
For the year:					
Net revenues	345,890	197,514	140,417	97,479	50,065
Cost of revenues	73,854	40,862	30,447	22,900	15,773
Research and development	38,076	20,523	17,108	10,665	7,021
Sales and marketing	85,070	57,668	42,512	26,027	11,916
General and administrative	22,003	17,555	9,443	8,784	4,698
Income from operations	126,887	60,906	40,907	29,103	10,657
Non-operating income (loss)	8,638	5,078	1,936	(1,073)	407
Stock option bonus (expense)	(14,187)	—	—	—	—
Income before income taxes	121,338	65,984	42,843	28,030	11,064
Provision for income taxes	49,460	26,730	18,742	12,150	4,577
Net income	71,878	39,254	24,101	15,880	6,487
Capital expenditures	58,017	14,108	6,576	5,837	3,230
Depreciation	7,551	5,754	3,462	2,068	1,007
At year-end:					
Current assets	213,002	147,980	52,066	37,947	18,713
Net property, plant, and equipment	70,010	19,544	11,190	8,076	4,307
Other assets	4,742	3,215	1,808	1,614	1,308
Total assets	287,754	170,739	65,064	47,637	24,328
Current liabilities	46,644	29,528	10,624	16,489	9,689
Long-term liabilities	2,005	1,879	—	436	—
Stockholders' equity	239,105	139,332	54,440	30,712	14,639
Total liabilities and equity	287,754	170,739	65,064	47,637	24,328
Working capital	166,358	118,452	41,442	21,458	9,024
Number of employees	1,816	1,153	910	608	367
*Common stock data:**					
Net income per share	1.30	0.78	0.52	0.35	0.14
Book value per share	4.54	2.73	1.26	0.72	0.34
Cash and short-term investments per share	2.51	2.01	0.44	0.08	0.07
Average common and common equivalent shares outstanding	55,270	50,400	46,520	45,894	45,362
Shares outstanding at year-end	52,714	51,040	43,066	42,520	43,664
Key ratios:					
Current ratio	4.6	5.0	4.9	2.3	1.9
Return on net revenues	20.8%	19.9%	17.2%	16.3%	13.0%
Return on average total assets	31.4%	33.3%	42.8%	44.1%	33.2%
Return on average stockholders' equity	38.0%	40.5%	56.6%	70.0%	56.6%
Growth percentages - increases:					
Net revenues	75.1%	40.7%	44.0%	94.7%	104.5%
Net income	83.1%	62.9%	51.8%	144.8%	85.0%
Net income per share	66.7%	50.0%	48.6%	150.0%	70.6%
Book value per share	66.3%	116.7%	75.0%	111.8%	76.3%

**Common stock data have been retroactively restated to reflect the August 1, 1987 two-for-one stock split described in Note 1 of Notes to Consolidated Financial Statements.*

Directors	William H. Gates	Chairman of the Board and Chief Executive Officer, Microsoft Corporation
	Jon A. Shirley	President and Chief Operating Officer, Microsoft Corporation
	David F. Marquardt	Partner, Technology Venture Investors
	Robert D. O'Brien	Chairman of the Board, PACCAR, Inc. (retired)
	Portia Isaacson	Chairman and Chief Executive Officer, Intellisys Corporation
Officers	William H. Gates	Chairman of the Board and Chief Executive Officer
	Jon A. Shirley	President and Chief Operating Officer
	Scott A. Oki	Senior Vice President, USA Sales and Marketing
	Steven A. Ballmer	Vice President, Systems Software
	Jeremy Butler	Vice President, International Operations
	Francis J. Gaudette	Vice President, Finance and Administration; Treasurer; Chief Financial Officer
	Joachim Kempin	Vice President, OEM Sales
	Thomas M. Lopez	Vice President, CD ROM Software
	William H. Neukom	Vice President, Law and Corporate Affairs; Secretary
	Min S. Yee	Vice President, Microsoft Corporation; Publisher, Microsoft Press
	Steven W. Gray	Corporate Controller

Annual Meeting	The Annual Meeting of Shareholders will be held on Friday, October 30, 1987 at 5:00 P.M., at the Bellevue Holiday Inn, 11211 Main Street, Bellevue, Washington.
Form 10-K	Copies of Microsoft's Annual Report on Form 10-K are available upon written request from the Investor Relations Department, Microsoft Corporation, 16011 NE 36th Way, Box 97017, Redmond, Washington 98073-9717.
Common Stock	Microsoft common stock is traded over the counter on the NASDAQ National Market System (MSFT).
Independent Accountants	Deloitte Haskins & Sells, Bellevue, Washington 98004
Legal Counsel	Shidler McBroom Gates & Lucas, Seattle, Washington 98104
Transfer Agent	First Jersey National Bank, One Exchange Place, Jersey City, New Jersey 07302

Corporate Headquarters

Microsoft Corporation
16011 NE 36th Way
Box 97017
Redmond, WA 98073-9717
USA

International Operations

Microsoft Pty Ltd
1/17 Rodborough Road
Frenchs Forest, NSW 2086
AUSTRALIA

Microsoft Canada Inc
6300 Northwest Drive
Mississauga, Ontario L4V 1J7
CANADA

Microsoft Ltd
Excel House
49 De Montfort Road
Reading
Berks RG1 8LP
ENGLAND

Microsoft SARL
No. 519 Local Quebec
91946 Les Ulis Cedex
FRANCE

Microsoft BV
Jupiterstraat 100
2132 HE Hoofddorp
HOLLAND

Microsoft Ireland
Blackthorn Road
Sandyford Industrial Estate
Dublin 18
IRELAND

Microsoft SpA
Via Michelangelo 1
20093 Cologno Monzese-MI
ITALY

Microsoft KK
Sanbancho Yayoi-Kan
6-2 Sanbancho
Chiyoda-Ku, Tokyo 102
JAPAN

Microsoft Mexico
Reforma 300
Piso 20
Mexico DF
MEXICO

Microsoft AB
Skalholtsgatan 10B
Box 27
163 93 Spanga
SWEDEN

Microsoft GmbH
Erdinger Landstraße 2
8011 Aschheim/Dornach
WEST GERMANY

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Microsoft Corporation
16011 NE 36th Way
Box 97017
Redmond, WA 98073-9717
USA

Microsoft